

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 02-0120

**Financial Institutions Tax
For Tax Years 1994-1996**

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ISSUE

I. Financial Institutions Tax—Credit Card Operations

Authority: Quill Corporation v. North Dakota, 504 U.S. 298 (U.S. 1992); IC 6-5.5-3-1; IC 6-5.5-3-8; IC 6-5.5-4-4; IC 6-5.5-4-5; IC 6-5.5-4-6; IC 6-5.5-4-8; 45 IAC 17-2-8

Taxpayer protests imposition of Financial Institutions Tax on income from credit card-related activities.

II. Tax Administration—Negligence Penalty and Interest

Authority: IC 6-8.1-10-2.1; 45 IAC 15-11-2

Taxpayer protests imposition of a ten percent (10%) negligence penalty and interest.

STATEMENT OF FACTS

Taxpayer was a member of a group of companies which included several retail clothing store chains. Taxpayer ran the group's credit card operations from an out-of-state location. The Indiana Department of Revenue ("Department") conducted an audit for the tax years in question and issued proposed assessments along with a ten percent (10%) negligence penalty and interest for those years. Taxpayer protests that the proposed assessments are incorrect as are the imposition of the negligence penalty and interest. Further facts will be provided as necessary.

I. Financial Institutions Tax—Credit Card Operations

DISCUSSION

Taxpayer protests the imposition of the Financial Institutions Tax (FIT) for the tax years in question. The Department conducted an audit and concluded that taxpayer was subject to the FIT and issued proposed assessments. Taxpayer protests that it is not subject to the FIT and argues that it has not conducted business in Indiana as defined in FIT statutes. Taxpayer refers to

IC 6-5.5-3-8(5), and states that its only activity associated with Indiana falls within subsections (C) or (D).

IC 6-5.5-3-8 states:

Notwithstanding any other provision of this chapter, a taxpayer, except for a trust company formed under IC 28-1-4, is not considered to be transacting business in Indiana if the only activities of the taxpayer in Indiana are or are in connection with any of the following:

- (1) Maintaining or defending an action or suit.
- (2) Filing, modifying, renewing, extending, or transferring a mortgage, deed of trust, or security interest.
- (3) Acquiring, foreclosing, or otherwise conveying property in Indiana as a result of a default under the terms of a mortgage, deed of trust or other security instrument relating to the property.
- (4) Selling tangible personal property, if taxation under this article is precluded by 15 U.S.C. 381 through 384.
- (5) Owning an interest in the following types of property, including those activities within Indiana that are reasonably required to evaluate and complete the acquisition or disposition of the property, the servicing of the property, or the acquisition or liquidation of collateral relating to the property:
 - (A) An interest in a real estate mortgage investment conduit, a real estate investment trust, or a regulated investment company (as those terms are defined in the Internal Revenue Code).
 - (B) An interest in a loan backed security representing ownership or participation in a pool of promissory notes or certificates of interest that provide for payments in relation to payments or reasonable projections of payments on the notes or certificates.
 - (C) An interest in a loan or other asset from which the interest is attributed in IC 6-5.5-4-4, IC 6-5.5-4-5, and IC 6-5.5-4-6 and in which the payment obligations were solicited and entered into by a person that is independent and not acting on behalf of the owner.
 - (D) An interest in the right to service or collect income from a loan or other asset from which interest on the loan or other asset is attributed in IC 6-5.5-4-4, IC 6-5.5-4-5, and IC 6-5.5-4-6 and in which the payment obligations were solicited and entered into by a person that is independent and not acting on behalf of the owner.
 - (E) An amount held in an escrow or a trust account with respect to property described in this subdivision.
- (6) Acting:
 - (A) as an executor of an estate;
 - (B) as a trustee of a benefit plan;

- (C) as a trustee of an employee's pension, profit sharing, or other retirement plan;
- (D) as a trustee of a testamentary or inter vivos trust or corporate indenture; or
- (E) in any other fiduciary capacity, including holding title to real property in Indiana.

Since taxpayer states that its only activity relating to Indiana is described in IC 6-5.5-3-8(5)(C) and IC 6-5.5-3-8(5)(D), it is important to review the statutes listed therein. IC 6-5.5-4-4 states:

Interest income and other receipts from assets in the nature of loans or installment sales contracts that are primarily secured by or deal with real or tangible personal property must be attributed to Indiana if the security or sale property is located in Indiana.

IC 6-5.5-4-5 states:

Interest income and other receipts from consumer loans not secured by real or tangible property must be attributed to Indiana if the loan is made to a resident of Indiana, whether at a place of business, by a traveling loan officer, by mail, by telephone, or by other electronic means.

IC 6-5.5-4-6 states:

Interest income and other receipts from commercial loans and installment obligations not secured by real or tangible personal property must be attributed to Indiana if the proceeds of the loan are to be applied in Indiana. If it cannot be determined where the funds are to be applied, the income and receipts are attributed to the states in which the business applied for the loan. As used in this section, "applied for" means initial inquiry (including customer assistance in preparing the loan application) or submission of a completed loan application.

None of these activities describe taxpayer's business of issuing and servicing credit cards, and if these were the only statutes available, taxpayer might have a point. However, IC 6-5.5-4-8 explains:

Interest income, merchant discount, and other receipts including service charges from financial institution credit card and travel and entertainment credit card receivables and credit card holders' fees must be attributed to the state to which the card charges and fees are regularly billed.

Therefore, the portion of income taxpayer received from its Indiana customers must be attributed to Indiana since Indiana is the state to which the card charges and fees were regularly billed.

Taxpayer protests that it was not transacting business within Indiana. Taxpayer states that the employees of the retailers were not agents, employees or representatives of taxpayer and that agreements between taxpayer and retailers and their factoring companies disclaimed any agency

relationship among those parties. Taxpayer has not provided documentation establishing the nature of this relationship.

Also, IC 6-5.5-3-8 deals with “Events not considered transacting business in state”. Equally valuable is a review of IC 6-5.5-3-1, which deals with “Transacting business within state”. IC 6-5.5-3-1 states:

For the purposes of this article, a taxpayer is transacting business within Indiana in a taxable year only if the taxpayer:

- (1) maintains an office in Indiana;
- (2) has an employee, representative, or independent contractor conducting business in Indiana;
- (3) regularly sells products or services of any kind or nature to customers in Indiana that receive the product or service in Indiana;
- (4) regularly solicits business from potential customers in Indiana;
- (5) regularly performs services outside Indiana that are consumed within Indiana;
- (6) regularly engages in transactions with customers in Indiana that involve intangible property, including loans, but not property described in section 8(5) of this chapter, and result in receipts flowing to the taxpayer from within Indiana;
- (7) owns or leases tangible personal property or real property located in Indiana;
- or
- (8) regularly solicits and receives deposits from customers in Indiana.

45 IAC 17-2-8 explains:

A taxpayer is not required to be physically present within Indiana to be soliciting business. Soliciting business includes, but is not limited to, the following:

- (1) The distribution, by mail or otherwise, of catalogs, periodicals, advertising flyers, or other written solicitation of business to potential customers in Indiana, without regard to the state from where the distribution originated or where the materials were prepared.
- (2) Display of advertisements on billboards or other outdoor advertising in this state.
- (3) Advertisements in newspapers published in this state.
- (4) Advertisements in trade journals or other periodicals, the circulation of which is primarily within this state.
- (5) Advertisements in an Indiana edition of a national or regional publication or a limited regional edition of which this state is included as part of a broader regional or national publication, and which are not placed in other geographically defined editions of the same issue of the same publication.
- (6) Advertisements in regional or national publications in an edition which is not by its contents geographically targeted to Indiana, but which is sold over the counter in Indiana or by subscription to Indiana residents.
- (7) Advertisements broadcast on a radio or television station which are received by Indiana residents.
- (8) Any other solicitation by telegraph, telephone, computer data base, cable, optic, microwave, or other communication system.

Taxpayer states that the retailer's employees were not agents. While it has not been definitely established that the retailers and retailer's employees were not acting in an agency capacity, it remains that Indiana customers were acquiring taxpayer's credit cards. Therefore, either the retailers and their employees were acting as agents for taxpayer or taxpayer must have been distributing, by mail or otherwise, catalogs, periodicals, advertising flyers, or other written solicitation of business to potential customers in Indiana. One way or another, Indiana business was being solicited.

Since 45 IAC 17-2-8(1) establishes that taxpayer's activities constituted soliciting business in Indiana, IC 6-5.5-3-1(4) establishes that taxpayer was transacting business within Indiana for FIT purposes. Also, taxpayer regularly performed services outside Indiana that were consumed within Indiana which qualifies as transacting business within Indiana under IC 6-5.5-3-1(5). Therefore, taxpayer was transacting business within Indiana as explained by IC 6-5.5-3-1.

Next, taxpayer states that Indiana is prohibited from imposing FIT on taxpayer by the Commerce Clause of the United States Constitution. Taxpayer states that it has no substantial nexus with Indiana and a substantial nexus is required. Taxpayer refers to Quill Corporation v. North Dakota, 504 U.S. 298 (U.S. 1992), to support its contention that physical presence is required for a state to impose tax. Quill deals with use tax, as the Court explains when it discusses the Commerce Clause requirements, "In sum, although in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar, bright-line, physical presence requirement, our reasoning in those cases does not compel that we now reject the rule in *Bellas Hess* established in the area of sales and use taxes." *Id.*, at 317. Therefore, since the instant case deals with financial institutions tax rather than sales and use taxes, and the Court specifically states that the physical presence requirement has not been adopted for taxes other than sales and use, Quill provides no support for taxpayer.

In conclusion, 45 IAC 17-2-8(1) establishes that taxpayer's activities constituted soliciting business within Indiana. IC 6-5.5-3-1(4) establishes that taxpayer was transacting business within Indiana for FIT purposes. The Federal Commerce Clause does not prohibit Indiana from imposing FIT on a nonresident taxpayer.

FINDING

Taxpayer's protest is denied.

II. Tax Administration—Negligence Penalty and Interest

DISCUSSION

Taxpayer protests the imposition of a ten percent (10%) negligence penalty and interest, and states that the imposition of a negligence penalty is contrary to IC 6-8.1-10-2.1, which deals with the negligence penalty and its imposition. The Department refers to IC 6-8.1-10-1(e), which states, "Except as provided by IC 6-8.1-5-2(e)(2), the department may not waive the interest imposed under this section." Therefore, the Department may not waive interest.

Taxpayer states that the audit provides no indication of any wrongdoing on taxpayer's part to justify the imposition of penalties and that no factual basis exists. At hearing, taxpayer was adamant that it had diligently attempted to comply with Indiana's tax methods and that it should not be subject to the negligence penalty.

IC 6-8.1-10-2.1(f) explains:

The department shall adopt rules under IC 4-22-2 to prescribe the circumstances that constitute reasonable cause and negligence for purposes of this section.

The relevant regulation is 45 IAC 15-11-2(b), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to reach and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

Also, 45 IAC 15-11-2(c) provides in pertinent part:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, taxpayer has not affirmatively established that its failure to pay the full amount of tax due was due to reasonable cause and not due to negligence. As explained in Issue I, taxpayer was clearly soliciting business from within Indiana, which clearly qualified as transacting business within Indiana for FIT purposes. Taxpayer has not affirmatively established a reason why it did not pay the full amount of adjusted gross income tax due.

FINDING

Taxpayer's protest is denied.